

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to
Review Policies Concerning
Intrastate Carrier Access Charges

Rulemaking 03-08-018
(Filed August 21, 2003)

**COMMENTS OF THE UTILITY REFORM NETWORK AND
THE DIVISION OF RATEPAYER ADVOCATES
ON THE REVISED BUSHEY DRAFT DECISION
AND THE PEEVEY ALTERNATE DRAFT DECISION**

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CERTIFICATE OF SERVICE

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I. INTRODUCTION

Pursuant to Rule 77.3 of the Commission's Rules of Practice and Procedure, and the March 14, 2006 Notice of Availability, The Utility Reform Network (TURN) and the Division of Ratepayer Advocates (DRA)¹ submit these Comments on the Revised Bushey Draft Decision's (Bushey RDD)² and the Peevey Alternate Draft Decision (Peevey ADD).³

While DRA and TURN continue to oppose regulatory action that is aimed at ensuring "revenue neutrality" for SBC California (SBC) and Verizon California, Inc. (Verizon) by lowering intrastate access charges but increasing local rates, DRA and TURN urge the Commission to adopt the Bushey RDD and reject the Peevey ADD. DRA and TURN recommend some modifications to the Bushey RDD, such as clarification of the surcharge methodology and refocusing the scope of Phase III as applied to competitive local exchange carriers (CLECs), but generally support the Bushey

¹ The Office of Ratepayer Advocates (ORA) returned to being designated as the Division of Ratepayer Advocates (DRA) as of January 1, 2006.

² Revised Draft Decision of ALJ Bushey, "Final Opinion Modifying Intrastate Access Charges and Creating Memorandum Account" (mailed 3/14/2006).

³ Alternate Draft Decision of President Peevey, "Final Opinion Modifying Intrastate Access Charges and Creating Memorandum Account" (mailed 3/14/2006).

RDD as being, unlike the Peevey ADD, consistent with Commission precedent and good public policy.

Two aspects of the Peevey ADD are particularly egregious. First, the Peevey ADD requires ratepayers to subsidize all lost revenues associated with decreased access charges, including the “paper” losses of SBC and Verizon from access services “purchased” by their own affiliated interexchange carriers (IXCs). With the mergers of SBC and Verizon with AT&T and MCI, respectively, this approach disadvantages unaffiliated IXCs, and consequently harms competition. Second, the Peevey ADD establishes a procedural framework for allowing SBC and Verizon to continue charging ratepayers for lost access revenues in perpetuity, regardless of whether actual “lost” revenues decrease to the point of being *de minimis*. Unlike the Bushey RDD, the Peevey ADD invites SBC and Verizon to effectively freeze the amount of ratepayer surcharges after five years, despite the fact that the access services of the large ILECs – the number of intrastate access minutes purchased by IXCs – may continue to decrease. Finally, the Peevey ADD proposes these approaches with minimal, if any, explanation.

II. REVENUE NEUTRALITY SHOULD NOT BE GRANTED IN PERPETUITY

As TURN and DRA explained in their earlier Joint Comments, the NRF ILECs should not be granted eternal recovery of any lost revenues caused by the elimination of the NIC and the TIC rate elements.⁴ Considering that the Commission would effectively conclude, as a result of adoption of any of the three draft decisions before it, that the NIC and TIC are not cost-based, it defies logic to require ratepayers to “pay,” in lieu of the intrastate long distance carriers themselves, these NIC and TIC charges as long as SBC and Verizon provide a single minute of intrastate access.

Both the Bushey RDD and the Peevey ADD would allow SBC/AT&T and Verizon/MCI to increase local rates by a surcharge calculated using the same formula (in Attachment A to each DD). The original Bushey DD would have required booking

⁴ See Comments of the Utility Reform Network and the Division of Ratepayer Advocates on the Draft Decision (January 10, 2006) at 5-7.

actual lost revenues to a memorandum account, in light of the contentious nature of forecasting proceedings.⁵ The Bushey RDD and Peevey ADD both would use a forecasting methodology that is based on actual revenue losses, with certain adjustments, calculated on an annual basis with an annual Advice Letter filing. However, DRA and TURN have urged the Commission to gradually ratchet down recovery, such as decreasing recovery by 5-10% each year, until the amount zeros out.⁶ All three draft decisions reject this proposal and instead effectively allow recovery in perpetuity.⁷ Allowing such perpetual recovery is inconsistent with the NRF principles, prior Commission decisions, and clearly contrary to the IRD decision, D.94-09-065. In that decision, the Commission explicitly refused to make what were then known as Pacific Bell and GTEC whole for competitive losses.⁸

III. INTRA-LEC AND AFFILIATE ACCESS CHARGES SHOULD NOT BE INCLUDED IN THE RATEPAYER SURCHARGE

DRA and TURN fully support the Bushey RDD's proposal to exclude intra-LEC and affiliate transfers from the amount to be recovered from local customers. Unlike the Peevey ADD, the Bushey RDD recognizes the significance of the recent merger of SBC and AT&T and the merger of Verizon and MCI, especially the fact that the new consolidated companies will have the lion's share of the long distance market. As such, the Bushey RDD acknowledges the undisputed facts that "[a] substantial share of the NIC and TIC transfers are intra-LEC or affiliate transfers for both Verizon/MCI and SBC/AT&T. The affiliated entities realize no revenue from these transfers, thus discontinuing NIC and TIC will have no revenue effect on the affiliated entities."⁹ Applying the Commission's rate rebalancing principles, the Bushey RDD finds that

⁵ Draft Decision of ALJ Bushey, "Final Opinion Modifying Intrastate Access Charges and Creating Memorandum Account" (mailed 12/19/2005) (Original Bushey DD) at 8.

⁶ Reply Comments of The Utility Reform Network and the Office of Ratepayer Advocates on the Phase II Issues (March 7, 2005) at 7.

⁷ Original Bushey DD at 6, 8-9; Bushey RDD at 6, 8-9; Peevey ADD at 6, 8-9.

⁸ D.94-09-065, *mimeo*, at 164-65.

⁹ Bushey RDD at 10-11 (footnote omitted)

“[i]ncluding intra-LEC and affiliate transactions in calculating the rate surcharge for local customers has the strong potential to create a substantial windfall for the Verizon/MCI and SBC/AT&T by offsetting a paper transfer with an actual rate increase.”¹⁰

The Bushey RDD also presents a cogent rebuttal to arguments made by SBC/AT&T and Verizon/MCI that excluding intra-LEC and affiliate transactions from the surcharge calculation would deprive the ILECs of the opportunity to earn their authorized return. The Bushey RDD finds as follows:

Removing the NIC and TIC cost elements for access charges imposed on independent carriers will put these carriers on the same cost footing as the Verizon/MCI and SBC/AT&T currently enjoy in setting prices. If, after being relieved of the NIC and TIC cost burdens, the independent carriers are able to reduce their prices below Verizon/MCI's and SBC/AT&T's, these lower prices will be due to other factors, such as efficiency. Our rate rebalancing principles do not require that Verizon/MCI's and SBC/AT&T's opportunity to earn their authorized return be protected from such consequences.¹¹

While both the Bushey RDD and Peevey ADD assert that the purpose of the instant proceeding was to further the Commission's long-standing goal of fair competition in the long distance market,¹² only the Bushey RDD actually attempts to advance that policy. By excluding the intra-LEC and affiliate transfers from the customer surcharge, the Bushey RDD takes a significant step towards leveling the playing field for all long distance carriers.

In comparison, the Peevey ADD ignores the recent mega-mergers, ignores the consolidation of the long distance market, and ignores the Commission's rate rebalancing principles. By allowing the large ILECs to recover revenues associated with intra-LEC and affiliate transfers, the Peevey ADD not only disadvantages the modest (and diminishing) amount of non-ILEC-affiliated long distance competition that remains in the

¹⁰ Bushey RDD at 11.

¹¹ Bushey RDD at 12.

¹² Bushey RDD at 4; Peevey ADD at 4.

market, but also provides the two dominant carriers a free source of revenue at the expense of consumers. It is ironic that this proceeding, which was instigated by a petition by the then-independent AT&T in an effort to create a more competitive telecommunications market, has morphed into another vehicle for the dominant local carriers to own the entire telecommunications market and to extract more fees from consumers, with the blessing of the Commission.

The Peevey ADD provides no explanation for its failure to take into account the profoundly changed telecommunications market. Like the Bushey RDD, the Peevey ADD references the Commission's Phase I determination to allow the large ILECs increases in local revenues to offset any access charge reductions.¹³ Like the Bushey RDD, the Peevey ADD notes the landmark mergers approved by the Commission late last year.¹⁴ Like the Bushey RDD, the Peevey ADD even makes the following assertions:

In D.04-12-022, we also discussed the undesirable effect of excessive access charges on competition where not all market participants are subject to the charges. Changes in California's telecommunications market, namely the mergers of the two largest local exchange carriers with the two largest long distance carriers, discussed above, and the local exchange carriers' entry into the long distance market, have greatly diminished the fraction of the long distance market actually paying the access charge to an unaffiliated entity. To the extent access charges are set above cost, local exchange carriers and their affiliates incur lower costs than independent carriers, which could undermine our goal of a fair and competitive market.¹⁵

But while the Bushey RDD then goes on to engage in a detailed analysis of the Commission's express intentions in this proceeding, the changed circumstances resulting from the mergers, and the public policies implicated,¹⁶ the Peevey ADD is silent except for one unexplained statement. The Peevey ADD states that its proposed methodology

¹³ Peevey ADD at 3; Bushey RDD at 2-3.

¹⁴ Peevey ADD at 3-4; Bushey RDD at 3.

¹⁵ Peevey ADD at 4; Bushey RDD at 4.

¹⁶ Bushey RDD at 9-13.

for applying surcharges on local telephone bills “includes NIC and TIC collections from all long distance providers, including SBC’s and Verizon’s own long distance services and their affiliates, consistent with our decision in D.04-12-022.”¹⁷ The Peevey ADD does not articulate how, in fact, its approach is consistent with D.04-12-022, or with its earlier conclusion that ILEC-affiliated IXCs “incur lower costs than independent carriers” such that the long distance market could be harmed.

Finally, the Peevey ADD’s approach also has the potential to offer SBC and Verizon a perverse incentive: because the surcharge amounts the ILECs would collect from ratepayers would vary with the number of intrastate access minutes purchased by IXCs, and the Peevey ADD allows recovery for access services to ILEC-affiliated IXCs, there is an incentive for SBC and Verizon to increase the intrastate access traffic with their affiliated IXCs. To the extent that traffic can be routed and characterized in a variety of ways, the only loser in this scenario is the ratepayer. Further compounding this incentive, the Peevey ADD enables SBC and Verizon to effectively “freeze” ratepayers surcharges after five years. In other words, the “lost” access revenues that SBC and Verizon can document as of four to five years from now can be the basis for the following years’ surcharges in perpetuity. Accordingly, the Peevey ADD builds in an incentive for SBC and Verizon to increase intrastate access minutes as much as possible for the next 5 years, and gives SBC and Verizon a greater opportunity to do so by including ILEC-affiliated IXC minutes in the surcharge.

IV. EVEN AFTER 5 YEARS, RATEPAYERS SHOULD NOT INCUR SURCHARGES FOR REVENUES THAT ARE NOT “LOST”

To the extent that the Commission intends to impose a ratepayer surcharge, DRA and TURN do not object to the basic forecasting method proposed by the Bushey RDD and the Peevey ADD (with the exception of clarifications that should be made, as discussed in Section V, below). In addition to the inclusion of NIC and TIC lost revenue from ILEC-affiliated IXCs, there is another difference between the Bushey RDD and the

¹⁷ Peevey ADD at 9.

Peevey ADD in how the forecasting method is implemented. The Bushey RDD would continue to apply the forecasting method every year so that ratepayer surcharges closely track the actual number of intrastate access minutes. The Peevey ADD, however, only requires use of the forecasts for five years, after which time the ILECs could petition the Commission to be relieved of the annual Advice Letter filing requirement, effectively resulting in a freeze of the surcharge according to the actual intrastate access minutes in years 4 and 5.

DRA and TURN urge the adoption of the Bushey RDD approach. It is sound, and squarely within standard ratemaking and cost recovery principles. It ensures that the ILECs will recover their foregone revenues, and *only* those actual foregone revenues, because it is adjusted annually. Furthermore, continued yearly filings would enable the Commission to confirm ILEC implementation of the forecasting method, if necessary. In contrast, the Peevey ADD's approach of permitting elimination of the annual filing requirement would apparently then lock in perpetual recovery of whatever the surcharge amount was for the fifth year. Absent an annual adjustment of the amount to be recovered through the surcharge, the surcharges would be likely to generate windfalls for the ILECs, who themselves have asserted that NIC and TIC revenues are declining. Both the Bushey RDD and the Peevey ADD note this.¹⁸

Locking in a perpetual revenue stream for a declining revenue loss is nothing less than free money to the ILECs – funded by their ratepayers. This result would be wholly inappropriate. Additionally, in the absence of an annual filing, the Commission would have no documentation which could be used to review the accuracy of the forecasted recovery amount or the numbers upon which that forecast was based.

V. THE SURCHARGE METHODOLOGY SHOULD BE CLARIFIED

The proposed surcharge method in both the Bushey RDD and the Peevey ADD require clarification. Aspects of both (1) the method for calculating the amounts to be recovered through the surcharge, and (2) the method for calculating the surcharge itself,

¹⁸ Bushey RDD at 8, 13; Peevey ADD at 9.

are open to different interpretations that should be addressed by the Commission in the final decision of this phase.

For calculating the amount to be recovered, the first step is to “[d]etermine the amount of revenue that would have been realized from carriers as specified in D.06-04-0— if NIC and TIC were still in place in previous year.”¹⁹ The DDs (including the original Bushey DD) all contain references to the 2004 revenue amounts asserted by the ILECs. However, assuming that the Commission votes a decision out in 2006, DRA and TURN interpret the formula to require use of 2005 revenues. DRA and TURN do not object to use of 2005 data, but suggest that the DDs be clarified to explicitly state that 2005 is the starting year for the revenue calculation.

The formula next requires that one “Adjust revenue amount by percentage change in access minutes between previous two years.”²⁰ It is not at all clear what this means. For example, if the base year data were 2006, is the percentage change calculated using the change in minutes between those recorded for 2005 versus those recorded for 2006, or the change between 2004 and 2005, or is one to average the change in minutes over both 2004 and 2005? The DDs should clarify this aspect of the formula.

The last step for the method of calculating the amount to be recovered concludes that “Adjusted revenue amount is the forecasted amount to be recovered through the surcharge.”²¹ ORA and TURN interpret this to mean that the surcharge recovery is on a *prospective* basis, *e.g.* the surcharge amount for 2007, which would begin being assessed in January of 2007, is the forecasted amount based on the changes in 2005 minutes. However, this interpretation does not square with the desire to avoid “forecasting” expressed in both the Bushey RDD and the Peevey ADD.²² The proposed formula clearly requires clarification, and potentially textual changes to reflect that the proposed method includes an element of forecasting, albeit one that is different from the approach once

¹⁹ Attachment A to Bushey RDD and Peevey ADD (Attachment A).

²⁰ Attachment A.

²¹ Attachment A.

²² Bushey RDD at 8; Peevey ADD at 9.

proposed by the ILECs to forecast revenue losses based on 2004 numbers, if that is indeed the case.

With regard to the method for calculating the surcharge itself, the Commission does not resolve a critical issue – how to accomplish step one, which is to “Determine the billing base in minutes of use to which the surcharge will be applied for the previous year.”²³ As DRA and TURN discussed in previous comments, SBC and Verizon had initially proposed different services that would constitute the “billing base.”²⁴ In testimony, SBC proposed to use its Tariff Rule 33 surcharge mechanism, but only applied to exchange services.²⁵ DRA and TURN recommend that the Commission reject SBC’s approach in favor of a ratemaking method, such as that originally proposed by Verizon, that would lessen the impact of the surcharge on residential basic exchange subscribers. In a declaration, Verizon proposed to offset a certain amount of the amount to be recovered with rate increases to Category II services that would “bring rates more in line with market rates.” In addition, Verizon proposed to spread the remaining amount to be recovered “across the local billing base via the schedule A-38 surcharge mechanism.”²⁶ DRA and TURN therefore urge the Commission to explicitly resolve this issue in accordance with the approach proposed by Verizon in its February 14, 2005 testimony, in discretionary services are targeted for more than one-half of the amounts to be recovered, with a specific allocation to business basic exchange services.²⁷

²³ Attachment A.

²⁴ Reply Comments of The Utility Reform Network and the Office of Ratepayer Advocates on the Phase II Issues (March 7, 2005) (DRA/TURN 3/7/05 Reply Comments) at 6.

²⁵ Testimony of Mark Berry In Support of the Proposal of Pacific Bell Telephone (SBC California) (U 1001 C) to rebalance NIC revenues (Feb. 14, 2005) (SBC Testimony) at 9.

²⁶ Declaration of Dr. Robert T. Tanimura (Feb. 14, 2005) (Verizon Declaration) at 2-3. Verizon proposes to increase rates for: “1) business basic exchange, 2) former-Contel residential basic exchange service (to bring into parity with former-GTE rates), 3) remote call forwarding, 4) additional directory listings, 5) directory assistance, 6) coin sent paid operator handled surcharge, 7) business traffic study service, and 8) digital channel service.” Verizon Declaration at 3.

²⁷ On March 28, 2005, Verizon revised its rate design proposal. Letter to ALJ Kim Malcolm, CPUC, from Elaine M. Duncan, Verizon, dated March 28, 2005 (submitting a revision to the 2/14/05 Declaration of Dr. Robert T. Tanimura).

VI. THE COMMISSION SHOULD NOT REGULATE THE ACCESS CHARGES OF CLECS OR REQUIRE A COST ANALYSIS

The proposed schedule of both the Bushey RDD and the Peevey ADD requires “each carrier” to file and serve testimony (presumably or comments) on May 19, and provides for reply on June 9.²⁸ DRA and TURN first note that this language should be clarified to state that all *parties* are afforded the opportunity to file, particularly in the reply phase.

Additionally, DRA and TURN understand the Bushey RDD and Peevey ADD to be seeking such filings from all “local exchange carriers,” which by definition include not only the small and mid-sized ILECs, but CLECs. Such testimony is to be focused on the following:

[I]dentifying and quantifying any non-cost-based elements in current access charges, addressing whether the policy adopted in today’s decision should be extended to specific carriers, showing any local service rate implications of rate rebalancing (with any California High Cost Fund affects [*sic*]), and including any other information the carrier believes will be helpful to the Commission when considering this question.²⁹

The Bushey RDD and Peevey ADD should be clarified to make this requirement specific to ILECs only, and to exclude CLECs. As DRA and TURN stated at a PHC³⁰ and in prior Comments,³¹ the Commission should not deviate from its prior decisions wherein it declined to examine CLEC costs or set CLEC rates. For example, in D.96-03-020, the Commission considered whether CLECs should be subject to any pricing

²⁸ Bushey RDD at 14; Peevey ADD at 11.

²⁹ Bushey RDD at 14; Peevey ADD at 11. Ordering Paragraph 4 in both new draft decisions makes it clear that the obligation to provide a written analysis of any non-cost-based elements applies to CLECs: “The local exchange carriers other than SBC and Verizon shall adhere to the procedural schedule set forth above.”

³⁰ See RT Vol. PHC-1 at 33-34 (November 19, 2003).

³¹ Comments of The Utility Reform Network and the Office of Ratepayer Advocates Regarding Access Charge Reform (October 24, 2003); Reply Comments of The Utility Reform Network and the Office of Ratepayer Advocates Regarding Access Charge Reform (November 12, 2003).

regulation and the filing of formal cost studies.³² The Commission concluded that, in light of the non-dominant status of CLECs, the competitive marketplace obviated the need for any rate regulation.³³ There is no doubt that CLECs continue to be non-dominant, and no party has provided a compelling basis for regulating any CLEC rates, including access charges, at this time. As of today, there are 500 carriers authorized to provide local exchange service in California, or portions thereof.³⁴ As each of the draft decisions state, “competitive carriers are not required to provide cost support for their services and have flexible pricing rules.”³⁵ It would therefore be inconsistent with the Commission’s policy decisions to limit price regulation of CLECs to order a reduction in the intrastate access charges of CLECs. Therefore, there is no reason to continue to require CLECs to be respondents in this proceeding, thus obviating the need for any further expenditure of resources by both parties and the Commission on this issue.

Furthermore, both the Bushey RDD and the Peevey ADD seek CLEC testimony that is inconsistent with D.04-12-022. In Phase I of this proceeding, the Commission evaluated the question of whether it should consider regulating the access charges of CLECs in this proceeding and concluded that CLEC access charges should be “reviewed:”

As with the issue of access charges for small and mid-sized LECs, the revenues corresponding to [CLEC] access charges that might be implicated in this proceeding are almost certain to be relatively small. Nevertheless, as a matter of fairness and in recognition that CLECs may increasingly provide access to customers, we intend to review CLEC access charges. We recognize that the effort required to establish cost-based access charges would be daunting and consider alternatives to that exercise. As with small and mid-sized

³² D.96-03-020, 65 CPUC.2d 156, 197-198.

³³ *Id.*

³⁴ http://telweb1.cpuc.ca.gov/carriersearch/app/carrier_external_search/list.asp (accessed April 3, 2006). This number does not include authorizations that have been revoked.

³⁵ Original Bushey DD at 10; Bushey RDD at 14; Peevey ADD at 11.

companies, we intend to consider this question and conduct this formal review in a third phase of this proceeding.³⁶

The Commission went on to consider the option of using SBC and Verizon access charges as proxies – as a ceiling or benchmark, for example – for the access charges of CLECs and the small and mid-sized LECs.³⁷ The Commission concluded that such an approach “may be a reasonable alternative to developing costs for each of these companies. We will develop options in Phase III of this proceeding.”³⁸

Despite these conclusions in D.04-12-022, both the Bushey RDD and the Peevey ADD inexplicably impose on the hundreds of CLECs the burden of “identifying and quantifying any non-cost-based elements in [their] current access charges,” among other things, in testimony.³⁹ Both of the recent draft decisions do not, in fact, appear to “consider alternatives” or invite other “options,” despite having “recognized” in D.04-12-022 that “the effort required to establish cost-based access charges [for CLECs] would be daunting.”⁴⁰

In fact, both draft decisions would require LECs other than SBC and Verizon to engage in an analysis of their access charge costs and rates that the Commission itself has declined to do with respect to SBC and Verizon. The Commission has never identified the access-associated costs that the NIC and TIC are intended to recover for SBC and Verizon. As DRA and TURN have previously noted, this is a fundamental step for analyzing whether a specific rate element is “cost-based.”⁴¹ Thus, it is particularly inappropriate to require CLECs to undertake a costing analysis of their intrastate access charges.

³⁶ D.04-12-022, *mimeo*, at 17.

³⁷ D.04-12-022, *mimeo*, at 17.

³⁸ D.04-12-022, *mimeo*, at 17.

³⁹ Bushey RDD at 14; Peevey ADD at 11.

⁴⁰ D.04-12-022, *mimeo*, at 17.

⁴¹ As DRA and TURN stated in 2004, “the process of establishing cost-based access charges will necessarily involve a comprehensive review of costs and a determination of which costs are appropriately attributed to access charges.” Reply Comments of the Office of Ratepayer Advocates and The Utility Reform Network on Access Charge Reform Issues (October 7, 2004).

In sum, if the Commission seeks to reduce CLECs' access charges, it should not require CLECs to conduct the burdensome costing analysis ordered in the Bushey RDD and the Peevey ADD, but should invite and consider other options consistent with D.04-12-022.

VII. CONCLUSION

For the reasons identified herein, TURN and DRA urge that the revised Bushey Draft Decision be adopted, with the modifications discussed herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of “**COMMENTS OF THE UTILITY REFORM NETWORK AND THE DIVISION OF RATEPAYER ADVOCATES ON THE REVISED BUSHEY DRAFT DECISION AND THE PEEVEY ALTERNATE DRAFT DECISION**” in **R.03-08-018** by using the following service:

[**X**] **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

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Executed on **April 3, 2006** at San Francisco, California.

/s/ Rebecca Rojo
Rebecca Rojo

N O T I C E

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